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SOME GENERAL OBSERVATIONS ON THE NEW BUSINESS CORPORATION LAW OF NEW YORK

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EVEN a cursory study of New York's new Business Corporation Law[1] gives anyone who has been professionally involved in corporation law a feeling of admiration for an achievement masterly both in conception and execution. Like a masterpiece of functional architecture, the work presents simplicity and symmetry in outer form to house complex practical operations within. It proves that impressive results can be achieved by a highly organized and skilled team of specialists.

A camel, some wag has observed, is a horse conceived and put together by a committee. If this wag would examine the new Business Corporation Law, his misgivings about teams and committees might vanish. This job was, indeed, one done by teams and committees, through processes and programs best described elsewhere in this symposium. Never was a corporation law in the world's history, one ventures, conceived, constructed, added to, subtracted from, screened, aired and polished by so many committees, staffs, standing subcommittees, special subcommittees, drafting consultants, researchers, advisors, liaisons, hearings, correspondence and reports. It is fascinating to watch the machinery of this vast legislative process at work—like watching the machines in operation at a printing plant.[2]

To this fascination must be added a tinge of awe at the resources in talent and money that were at the service of New York's Joint Legislative Committee to Study Revision of Corporation Laws. Most states that have undertaken such revision have proceeded with slim resources. I recall one state where a group of enthusiastic lawyers got together, years ago, virtually without a budget, to prepare a revision of the state's corporation laws in the course of a hopeful series of monthly meetings. At each meeting the number of busy lawyers who turned up was about one half the number who had previously attended, until the group dwindled down to the chairman and about three or four hardy souls, whereupon the project was shelved. In other states, a typical pattern has been for a small committee on corporation law of the state bar association to undertake the revision, usually a group with little patience or sympathy with points of view not identified with the interests of their clients. Still other states take the way out that is easiest in money, time, and trouble and just buy a ready-to-wear suit, with minor adjustments for sleeve length and trouser cuffs. Not so New York.

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1. New York Business Corporation Law of 1961 (hereafter cited as N.Y. Bus. Corp. Law), N.Y. Sess. Laws 1961, ch. 855. (To be effective September, 1963).

2. A general idea of how the various parts of the machinery functioned can be formed through the various interim reports of the top committee. For citations, see other articles in this Symposium.

Anyone who studies the Business Corporation Law with a comparative background in state corporation laws must appreciate that an enormous amount of research and analysis of the details of the corporation laws, statutory and judge-made, of all of the states went into the drafting of the new act. I venture that there is hardly an indigenous idea from anywhere in the country that was overlooked, even if only to be rejected.

Accordingly, here perhaps is the Model Act which might well be the greatest source for inspiration and emulation for states contemplating a revision of their corporation laws. The Business Corporation Law has a universal quality that could, with occasional minor change of detail, justify its enactment just about anywhere, whether in an agricultural state or an industrial-commercial-financial state. And it has achieved this quality without that meticulous avoidance of all tough policy choices or of all controversial questions which in corporation-law drafting can result in a statute which comes close to being merely a technician's manual.

The Business Corporation Law As An Enabling Act And Technical Achievement

Of course, no corporation act in any state is merely a technician's manual that avoids all policy questions or all controls over the doings of corporations—not even those states most eager for corporate fees with which to finance their schools and roads. For example, nearly every corporation act puts *some* limitation on dividends; at least insolvency. But the tendency of the corporation acts that have been adopted in the United States after the 1930's has been largely to limit controls to those few that are unavoidable in business units with limited liability and to focus on technical aspects of the corporate mechanism so that the machine can move smoothly, quickly, powerfully, fully under control of the man or group at the wheel. Nevertheless, corporation law abounds with sensitive areas (of which more later in this paper), as is borne out not only by the constant stream of judicial decisions, but also by even casual experience with modern doings by and within corporations.

Dissatisfaction over these sensitive areas, however, has not nowadays reached such dramatic proportions as to catch the public interest; and in the upper levels of corporate criticism and analysis, the concern today is chiefly with the broader sociological, economic, and policical implications of the big corporation.[3] Let's face it: In corporation law, these are not days that stir men's souls. Except for the uncompetitive proclivities of some business units in certain industries in bidding for business—a problem more in the antitrust field—no scandals have arisen of recent years to compare with those associated a generation ago with the names of Krueger, Insull, Richard Whitney, the brothers Musica, *et al.* The corporate misdeeds that afforded a precarious,

3. See the essays by Chayes, Rostow, Brewster, et al. in Mason, The Corporation in Modern Society (1960).

though at times generous, livelihood for Mr. Clarence H. Venner have undergone, if not reformation, at least refinement and polish. (However, a tempest may be currently in the making, centering on stock selling shenanigans—"hot issue" rigging, unloading by advisory services, "reloading," "tie-in" sales, "stalls," "boiler room" operations, etc.) And we have not had a stock market crash, much less a great depression, with millions of disillusioned security holders out for blood. All in all, we are in a fairly complacent mood, and contemporary revisers of corporation laws have been less concerned with drafting what we may call "protective" features, except possibly when that can be done rather painlessly,[4] than with what can be called "enabling"[5] features or purely technical ones calculated to see that the wheels spin smoothly, without shimmy, wobble or unbalance. Whether the Business Corporation Law wholly fits this pattern will be touched upon later; for the moment, our observations will focus on the enabling or technical features, including matters of style.

1. *Drafting style*—The Business Corporation Law is, on the whole, impressive in drafting style despite some unevenness in the various articles of the statute. Again and again, one sees ideas encountered in the old General Corporation Law or Stock Corporation Law of New York or in the corporation laws of other states but now set forth in the Business Corporation Law with a clarity and precision and with an economy of words that contrast sharply with earlier New York verbosity.[6] The simplicity with which the Business Corporation Law states the rule of once-a-quorum-always-a-quorum[7] or authorizes adjournment by the shareholders present without a quorum[8] looks easy, for example, once you see it done, as in the anecdote of Columbus and the egg; but that simplicity can be better appreciated when one sees how statutes elsewhere have tried to say the same thing. Obviously, time and devotion were given without stint to redrafting, reworking, repolishing. Even the format, indentation, lettering, and numbering of the subsections and paragraphs are so contrived as

4. An example might be the familiar restriction on the corporate name so that it will indicate limited liability, or so that it will not be deceptively similar to that of another corporation. N.Y. Bus. Corp. Law § 301(a)(1), (2) is typical.

5. These terms ("protective," "enabling," "technical") are obviously neither scientific nor precise nor exclusive of each other. For example, to require, as do N.Y. Bus. Corp. Law §§ 304, 402(a)(7) and 1304(a)(5) that corporations, foreign and domestic, designate the secretary of state as process agent and that this official be the process agent, coupled with permissive section 305 for designating in addition a "registered agent" for process, presents a scheme that is "protective" of persons with claims against corporation as well as "enabling" and procedurally "technical."

6. E.g., N.Y. Bus. Corp. Law § 905 (and related sections) as compared with N.Y. Stock Corp. Law § 85 (and related sections) on merger of subsidiary corporations; N.Y. Bus. Corp. Law § 1104(a) as compared with N.Y. Gen. Corp. Law § 103 on deadlock dissolution. Or see the definition of "earned surplus" as compared with that found in other states. N.Y. Bus. Corp. Law § 102(a)(6). Other examples: N.Y. Bus. Corp. Law § 108 on notices to stockholders when communication with them is unlawful; N.Y. Bus. Corp. Law § 760(c)(1) on removal of directors in a corporation with cumulative voting.

7. N.Y. Bus. Corp. Law § 608(c).

8. N.Y. Bus. Corp. Law § 608(d).

to enhance the clarity and to enable the busy lawyer to find and grasp the point with a minimum of time.[9]

Particularly notable is the fact that despite the emphasis on clarity and precision, the draftsmen did not show exaggerated literal-mindedness. For example, the Business Corporation Law speaks of paying dividends "out of surplus" and "out of stated capital."[10] Some overly precise technician might object that dividends are paid out of assets (usually a bank account) and not "out of" an accounting concept like "surplus," but everybody understands what the draftsmen mean. Everybody "in the know" talks that way about dividends, and there is no possible chance for confusion or misunderstanding. (In the same vein, perhaps the Business Corporation Law might well have used the phrase "share dividend" instead of a "distribution" of its shares.)

So good is the style of draftsmanship as a whole that the occasional departure comes as a bit of shock, as in Section 910 where the paragraphs of subsection (a) dangle in mid-air and one has to read them over and over to see how they fit in.

2. *"Thinking through" in substance*—The substance of the Business Corporation Law displays, within the chosen policy, as superior a drafting craftsmanship as does the style. Obviously, in each section, subsection, paragraph, sentence, and phrase, the point under consideration was "thought through" with the highest professional competence. Besides a firm grasp of practicalities, "close thinking" is apparent. A few examples will make the point. Unlike parallel provisions in other states, wartime per se does not transform the corporation into an all-purpose-war-prosecuting concern; but instead, wartime intra vires expansion hinges on "the request or direction of any competent governmental authority."[12] Again, not only is the alleged common-law prohibition against entering into partnership arrangements removed, but related associational activities of corporations, such as acting as promoter or manager, are recognized; and despite the fact that a corporation cannot be an incorporator of a New York corporation, the possibility of its being an incorporator elsewhere is recognized in the power clause expressly permitting a corporation (subject to charter limitations) to be an incorporator in states where that is allowed to a corporation.[13] Again, note the provision that *common* shares can be issued redeemable if there is outstanding another class of common that is not redeemable.[14] This is "closer thinking" than the usual understanding that only *preferred* shares can be made redeemable. Again, when the particular

9. See, for example, how readily the forbidden words for corporate names stand out in N.Y. Bus. Corp. Law § 301(a)(5) as compared with N.Y. Gen. Corp. Law § 9.

10. N.Y. Bus. Corp. Law § 513(a) and (b).

11. N.Y. Bus. Corp. Law § 511. But see De Capriles & McAniff, The Financial Provisions of the New (1961) New York Business Corporation Law, 36 N.Y.U.L. Rev. 1239, 1266-67 (1961).

12. N.Y. Bus. Corp. Law § 201(b).

13. N.Y. Bus. Corp. Law § 202(a)(15).

14. N.Y. Bus. Corp. Law § 512(c).

time has to be selected for determining who are shareholders for the purpose of notices, dividend checks, *et aliter*, where no record date is set, the Business Corporation Law carefully thinks through the practicalities by fixing the shareholders' list at the close of business of the *preceding* day for certain things and at the close of the *current* day for others.[15] Certainly "close thinking" is reflected in the provision that a shareholder purporting to dissent to a corporate move and to claim cash-to-dissenter rights cannot dissent as to less than all of his shares[16]—a provision aimed at the strategy whereby a shareholder will go along on the charter amendment, merger, or what-not as to all but one of his shares but will fight or threaten to fight the move in court (by injunction, say) with his one other share. (Maybe, however, this requirement will simply result in foresighted "bona fide" transfers of a few shares within the family.)

Even minor technical points have not escaped the draftsmen, as is shown, for example, by the words "whether civil or *criminal*" (Emphasis added.) in the provision against abatement of any action or proceeding against a constituent corporation in a merger or consolidation.[17] (It is by no means certain that without those quoted words criminal proceedings do not abate against a corporate entity that has technically disappeared in a merger or consolidation.)[18] The Business Corporation Law might do well, however, to cover the point specifically also in Section 1006 relating to dissolution.[19]

Time and again the Act "follows through" in its treatment of a particular situation. A good example of "follow through" thinking is revealed, against the background of an authorized charter clause permitting election of designated officers by the shareholders, in the statutory provision not allowing directors to *remove* officers so elected (unlike other officers), but at least allowing the directors to *suspend* them.[20] Similarly, "follow through" is seen in the coverage of the prescribed manner of dissent for a director not only when he attends a meeting but also when he is absent; and how his conduct will be viewed if he does nothing.[21]

With drafting of that caliber, the gears in the Business Corporation Law

15. N.Y. Bus. Corp. Law § 604(b).
16. N.Y. Bus. Corp. Law § 623(d).
17. N.Y. Bus. Corp. Law § 906(b)(3).
18. Under the Stock Corporation Law, which did not specifically cover this technical point, the cases reached a decision in line with the new Law but they were decided by federal courts. United States v. United States Vanadium Corp., 230 F.2d 646 (10th Cir. 1956), cert. denied, 351 U.S. 939 (1956); United States v. Cigarette Merchandisers Ass'n, Inc., 136 F. Supp. 214 (S.D.N.Y. 1955). Under statutes elsewhere without specific coverage of the point, cf. United States v. Line Material Co., 202 F.2d 929 (6th Cir. 1953). And cf., on dissolution, United States v. P. F. Collier & Son Corp., 208 F.2d 936 (7th Cir. 1953); United States v. Maryland State Licensed Beverage Ass'n, 138 F. Supp. 685 (D.C. Md. 1956).
19. See United States v. P. F. Collier & Son Corp., supra note 18; United States v. Maryland State Licensed Beverage Ass'n, supra note 18.
20. N.Y. Bus. Corp. Law § 716(a).
21. N.Y. Bus. Corp. Law § 719(b).

mesh smoothly most of the time. What seems to be a rare instance of failure in this respect is the Law's attempt to protect the liquidation priority of senior shares through the concept of "stated capital," which is not to be impaired by distributions to shareholders; yet it achieves this end only as to *no-par* senior shares, since as to shares *with* par value it is theoretically possible to set up as surplus that part of the consideration received for senior shares that is in excess of par, even if the consideration so received is below the liquidation priority of those senior shares.[22] But perhaps the trouble here is the attempt to maintain the integrity of "par value," a shibboleth that dies hard in corporation law. Anyhow, it has not been a business practice to issue preferred shares with any great discrepancy between par and liquidation priority.

Another good feature of the Business Corporation Law is that despite its 129 printed pages in the pamphlet before me, it cannot be successfully indicted for "overdrafting." True, some of the attempts to cope with complicated problems run into long and involved sections, like the one relating to the procedure for cash-to-dissenter shareholders, which runs over 2,000 words. The Law also contains probably the world's longest section on pre-emptive rights, but that is one of those subjects where the legislative draftsman, if he does not sweep the matter quietly under the rug, never finds a satisfactory stopping point. Indeed, despite its length, the Business Corporation Law may in spots be even underdrafted; it has, for instance, relatively little to say on the procedure for contesting a corporate election.[23]

3. *An "enabling" act*—As is to be expected of a mid-twentieth century American corporation law, the Business Corporation Law is in large measure an "enabling" act which permits the corporation to be formed and to operate easily without burdensome restrictions. One can almost say that whatever the corporate planners and managers want, within reason, is theirs for the asking, particularly in view of the oft-repeated authorization "if the certificate of incorporation so provides." The content of the certificate of incorporation, let us not forget, is within the control of the insiders, the promotional and managerial group.

It is just as well to see the jettison of many old restrictions familiar to American corporation law, which no longer serve any useful or significantly protective purpose. Accordingly, one sees in the Business Corporation Law authorization for broad corporate powers, including power to give guarantees, to make donations "irrespective of corporate benefit," and to participate as partner, promoter, manager, etc., in any venture, although there is still the general restriction that these freedoms are to be exercised in "furtherance of its corporate purposes,"[24] unless, with respect to a guaranty, there is approval

22. See N.Y. Bus. Corp. Law § 506(a) and (b) in the light of §§ 510(a) and (b), 513(b)(4), 516(b).

23. Cf. N.Y. Bus. Corp. Law § 619 with the probably overdrafted § 55-71 of the North Carolina Business Corporation Act.

24. N.Y. Bus. Corp. Law § 202(a). A nice technical point may arise on donations

by shareholders' vote.[25] But the purposes set forth in the charter can be as extensive as the draftsman's skill can make them.

At this point, it would have been perfectly in keeping with the spirit of the Act to accept as the basic pattern the all-purpose corporation, as one unsuccessful amending bill would have done, on the theory that if the interested parties want a narrow charter, let them so frame it,[26] particularly in view of the whittled-down doctrine of *ultra vires* in the Business Corporation Law.[27] In the same vein, since the old requirement of *three* incorporators is abolished (one suffices), it would have been logical to permit that the *one* incorporator be itself a corporation.[28] However, these are minor matters, involving ceremonials that add practically nothing to the cost of doing business.

The list of "enabling features" is, as to be expected, a long one, though mostly without significant novelty; the features here listed are mentioned not for exposure to analysis but as mere random illustrations of "enablingism." Shares can be issued with any kind of voting rights, whether single, multiple, partial, shifting, contingent or none.[29] (However, despite statutory silence, there must on basic principles of law be *a* voting class of shares somewhere in the corporation.) Similarly, just about any other attribute can be given to shares, including denial of rights such as pre-emptive rights, except that shares are not convertible "upstream" into senior securities nor at the option of the corporation,[30] nor can they be made redeemable at holder's option.[31] The attributes of the authorized shares can be left to be filled in by the directors ("blank stock").[32] Rather complete freedom is recognized for stock options.[33] Preincorporation subscription can be made irrevocable for a three-month period[34] without resort to fancy techniques for avoiding the pitfalls that the common law of corporations has raised in this area. Authority for at least reasonable restrictions on the transfer of shares as set forth in the certificate of incorporation, or perhaps even in the by-laws, seems implicit,[35] especially in the light of earlier judicial expressions, although many questions about restrictions are still left unanswered.[36] The awkward problem of fractional shares is solved by

which are permitted to be made "irrespective of corporate benefit (par. (12) of § 202(a)) but must still be in "furtherance" of the corporate purposes.

25. N.Y. Bus. Corp. Law § 908.

26. As is the case in three states. Iowa Code Ann. § 496A.49 (Supp. 1960); Nev. Rev. Stat. 78-035 (1960); Wis. Stat. § 180.45 (1957).

27. N.Y. Bus. Corp. Law § 203.

28. But the incorporator must still be a natural person. N.Y. Bus. Corp. Law § 401.

29. N.Y. Bus. Corp. Law §§ 501(a), 613.

30. N.Y. Bus. Corp. Law § 519(a).

31. N.Y. Bus. Corp. Law § 512(a).

32. N.Y. Bus. Corp. Law § 502(c). "Blank stock" provisions are now common in corporation laws.

33. N.Y. Bus. Corp. Law § 505.

34. N.Y. Bus. Corp. Law § 503(a).

35. N.Y. Bus. Corp. Law §§ 402(b), 508(d), 601(b), 501(a).

36. See Penthouse Properties, Inc. v. 1158 Fifth Ave., Inc., 256 App. Div. 685, 11 N.Y.S.2d 417 (1st Dep't 1939); Cowles v. Cowles Realty Co., 201 App. Div. 460, 194 N.Y. Supp. 546 (1st Dep't 1922).

authorizing the corporation to do whichever it wants—issue fractional shares and certificates therefor, issue scrip (exchangeable for a full share when enough scrip-fractions have been acquired by the holder, to which end the corporation may lend its help to bring buyers and sellers together), or just buy up the fraction.[37] No restraint is imposed on the purchase by a corporation of its own stock beyond the solvency and "surplus" requirements.[38] (But "surplus" itself is technically so designed as to make at least some attempt to protect even the liquidation priority of senior shares.) Directors are given a free hand on making or changing by-laws, if the certificate of incorporation is so set up.[39] Shareholders' pooling agreements for voting are permitted.[40]

New York's almost psychotic fear of "sterilized" directors has been considerably overcome in the new Law; accordingly, in close corporations, despite lip service to tradition in the statutory requirement of at least three directors, the affairs can be run under just about any partner-like arrangement the parties wish to adopt.[41] Also, an executive committee of the board is authorized, and the extent of the delegation of authority permitted to the executive committee is carefully set out,[42] in contrast to the vague, overstated delegation usually found in statutes of other states.

The adverse interest of directors does not per se make a corporate transaction void or voidable,[43] especially under appropriate provisions in the certificate of incorporation. A free hand can be given for removal of directors, with or without cause,[44] with the result that, particularly in a close corporation, the dominant shareholder can run the show regardless of the old doctrine that directors' powers come not from the shareholders but from the state.

Subject to certain safeguards, outstanding shares can be completely altered in their "rights," with the result that corporations have a pretty free hand in recapitalizations,[45] and without much constitutional law troubles with "vested rights."[46]

The foregoing is not a complete list of the "enabling" features of the Act but will suffice the reflect its "enabling" spirit.

4. *Simplification*—Another laudable quality in the new Business Corporation Law is its attention to simplification and avoidance of unnecessary red tape and anachronisms. Thus, traditional provisions paying lip service to the device of "closing the books" for fixing the time of determining who are the shareholders have been completely abandoned in favor of the modern device

37. N.Y. Bus. Corp. Law § 509.
38. N.Y. Bus. Corp. Law § 513.
39. N.Y. Bus. Corp. Law § 901.
40. N.Y. Bus. Corp. Law § 620(a).
41. N.Y. Bus. Corp. Law § 620(b).
42. N.Y. Bus. Corp. Law § 712(a).
43. N.Y. Bus. Corp. Law § 713.
44. N.Y. Bus. Corp. Law § 706.
45. N.Y. Bus. Corp. Law § 801(b)(11) and (12).
46. See McNulty v. W. & J. Sloane, 184 Misc. 835, 54 N.Y.S.2d 253 (Sup. Ct. 1945).

of fixing a record date.[47] Notice of an adjourned meeting is not required.[48] The purpose of directors' meetings need not, as far as the statute goes, be stated in notices of meeting.[49] In minor matters the certificate of incorporation can be amended by the board without shareholders' vote.[50] A restatement of the certificate of incorporation (if it is a *mere* restatement and not something more) can be filed pursuant to action by the directors, whereupon it becomes *the* certificate of incorporation.[51] No vote of shareholders is necessary to merge nearly wholly owned subsidiaries (95 per cent and up) into the parent.[52] The board itself may mortgage or pledge any or all corporate assets and if the transaction can be viewed as within the "usual or regular course of business," can make a sale or other disposition of all assets.[53] A single filing of a certificate of dissolution at the time that the decision to dissolve is made suffices, without need for further filings at the end of liquidation or other times.[54] Simplification in dissolution is achieved by the continued vitality, structure, and title to assets of the corporation after dissolution.[55]

5. *Some case-law repudiated*—It goes without saying that in the course of time, any jurisdiction builds up a body of judicial decisions, based by no means on any inescapable directive in the corporation statutes, and far less on good logic of common law or equity, that adopt doctrines of questionable soundness. New York is no exception. One does not lament, accordingly, the revisers' repudiation of a handful of New York cases, some of which have exerted their unfortunate influence on courts of other states. Some had already been whittled down by later cases. Thus *Munson v. Syracuse G. & C. R. Co.*[56] on the voidability of corporate transactions because of directors' adverse interest had been limited by *Everett v. Phillips*[57] and is now rejected in Business Corporation Law, Section 713 (a). *Topken, Loring & Schwartz v. Schwartz*,[58] already difficult to reconcile with *Cross v. Beguelin*,[59] is now repudiated, so that the mere theoretical possibility that a corporation *might not* have been able to repurchase its own shares for, say, lack of surplus, is no ground for not enforcing the repurchase contract if the corporation actually *is* able.[60] The strange notion expounded in *Gordon v. Elliman*[61] that a shareholder's

47. N.Y. Bus. Corp. Law § 604.
48. N.Y. Bus. Corp. Law § 605.
49. N.Y. Bus. Corp. Law § 711.
50. N.Y. Bus. Corp. Law § 803(b).
51. N.Y. Bus. Corp. Law § 807(a) and (f).
52. N.Y. Bus. Corp. Law § 905(a). But this does not mean that minority shareholders in the subsidiary cannot dissent and preserve their cash-to-dissenter rights. N.Y. Bus. Corp. Law §§ 905(c)(3), 623(a), 910(a)(1)(A).
53. N.Y. Bus. Corp. Law §§ 911, 909(a).
54. N.Y. Bus. Corp. Law § 1004.
55. N.Y. Bus. Corp. Law § 1006.
56. 103 N.Y. 58, 8 N.E. 355 (1886).
57. 288 N.Y. 227, 43 N.E.2d 18 (1942).
58. 249 N.Y. 206, 163 N.E. 735 (1928).
59. 252 N.Y. 262, 169 N.E. 378 (1929).
60. N.Y. Bus. Corp. Law § 514(a) and (b).
61. 306 N.Y. 456, 119 N.E.2d 331 (1954).

suit to compel payment of a dividend is a derivative suit would seem ended, even if only by second-look interpretation, by Business Corporation Law, Section 626 (a). The majority view expressed in *Eisen v. Post*,[62] that one looks to the charter and not to the business actually being conducted by a corporation to determine whether a sale of its assets is in the "regular course of business" so as to dispense with the otherwise required consent of the shareholders, is rejected by Business Corporation Law, Section 909, which looks to "the business actually conducted." And if the court meant to leave the impression in *In Re Radom & Neidorff, Inc.*,[63] that a court should not grant dissolution for deadlock and internal dissension as long as the corporation is making money, that impression is dispelled by the new Section 1112(b)(3) to the effect that dissolution is not to be denied merely because the corporation's business is being conducted at a profit.

However, there has been *no* repudiation—on the contrary, perhaps implied legislative approval—of the controversial case of *Randall v. Bailey*,[64] in the statutory declaration that unrealized appreciation of assets shall not be included in *earned* surplus.[65] (But now, when dividends are paid from a revaluation surplus, the shareholders getting the dividend must at least be so informed.)[66]

6. *Concern with the close corporation*—In recent years, revisers of corporation statutes have finally concerned themselves with something that the practicing lawyer has long been concerned with—the close corporation. Most lawyers spend more of their corporation-law worktime on this type of corporation than on the publicly-held type. The problems that have to be faced in the planning, forming, operation, and dissolution of a close corporation are crucial and difficult, as has well been brought out in the writings of my colleague, Professor O'Neal.[67] Traditionally, the corporation laws have been drafted with the publicly-held corporation in mind. Accordingly, the typical requirements of corporation law have ill suited the close corporation.

The new New York Act shows awareness of the problems of the closely-

62. 3 N.Y.2d 518, 169 N.Y.S.2d 15 (1957).
63. 307 N.Y. 1, 119 N.E.2d 563 (1954).
64. 23 N.Y.S.2d 173 (Sup. Ct. 1940), aff'd, 288 N.Y. 280, 43 N.E.2d 43 (1942). The decision upheld dividends paid from a surplus that arose from valuation upwards of the corporation's fixed assets.
65. N.Y. Bus. Corp. Law § 102(a)(6).
66. N.Y. Bus. Corp. Law § 510 (c).
67. See, e.g., O'Neal, Close Corporations: Law And Practice (1958); O'Neal, Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting, 65 Harv. L. Rev. 773 (1952); O'Neal, Giving Shareholders Power to Veto Corporate Decisions: Use of Special Charter and By-Law Provisions, 18 Law & Contemp. Prob. 451 (1953); O'Neal, Resolving Disputes in Closely Held Corporations; Intra-Institutional Arbitration, 67 Harv. L. Rev. 786 (1954); O'Neal, Molding the Corporate Form to Particular Business Situations; Optional Charter Clauses, 10 Vand. L. Rev. 1 (1956); O'Neal, Recent Legislation Affecting Close Corporations, 23 Law & Contemp. Prob. 341 (1958); O'Neal, Protecting Shareholders' Control Agreements Against Attack, 14 Bus. Law 184 (1958); O'Neal, Oppugnancy and Oppression in Close Corporations: Remedies in America and Britain, 1 Boston College Ind. & Com. L. Rev. 1 (1959); O'Neal, Arrangements Which Protect Minority Shareholders Against "Squeeze-Outs," 45 Minn. L. Rev. 537 (1961).

held corporation, although it meets these problems as part of its treatment of corporations generally, not by a separate statute. One sees in the Business Corporation Law certain sections obviously drafted with the close corporation in mind. Thus charter provisions for high-quorum and high-vote requirements for action by shareholders or by the directors are authorized.[68] A corporation does not have to be managed by the board of directors if the charter adopts a different plan of management, so long as the shares are not traded in the securities markets or regularly traded over the counter.[69] No notice of shareholders' meeting need be given to shareholders who sign waivers of notice.[70] Written consent of all the shareholders can be used in lieu of vote at shareholders' meeting.[71] Of course, the recognition of legality of shareholders' pooling agreements[72] is of more practical importance in close corporations than in others, and so is the provision that permits, if the charter so provides, specified officers to be elected by the shareholders rather than by the board.[73] The same is true of shareholders' two thirds approval of ultra-vires guarantees.[74] The dissolution-for-deadlock provisions were, obviously, drafted with close corporations primarily in mind.[75] And that debatable New York liability of shareholders for wages and salaries to employees, apparently impossible to jettison for political reasons, has at least been made applicable only to close corporations, [76] where its deterrent effect on attracting venture capital is somewhat limited. However, the revisers have not been sufficiently impressed by the informal habits of close-corporation personnel to give express approval to even habitually informal or irregular board action by directors.[77]

One cannot say, however, that a whole-hearted attempt has been made in the new law to cope with some of the abuses associated particularly with close corporations. But this observation leads to reflection on the place of "protective features" in general in a law for corporations, close or otherwise, and to what extent a corporation act may concern itself about, and attempt to control, the evils or abuses or "sensitive areas" to which the corporate mechanism is susceptible. To that we turn.

What Should a Corporation Act Try To Do? (Herein of Controls and "Protective" Features)

A corporation act is not the place for legislative attempts to cure all ills attributable to corporations, big and small, close or public. At any rate, in American tradition the enactment of a corporation law is not the occasion for

68. N.Y. Bus. Corp. Law §§ 616(a), 709(a).
69. N.Y. Bus. Corp. Law § 620(b) and (c).
70. N.Y. Bus. Corp. Law § 606.
71. N.Y. Bus. Corp. Law § 615(a).
72. N.Y. Bus. Corp. Law § 620(a).
73. N.Y. Bus. Corp. Law § 715(b).
74. N.Y. Bus. Corp. Law § 908.
75. N.Y. Bus. Corp. Law § 1104(a).
76. N.Y. Bus. Corp. Law § 630(a).
77. Cf. N.C. Gen. Stat. § 55-29 (1960).

the insertion of provisions directed against monopoly, trade-restraints, uncompetitive practices, vertical or horizontal integration, and the like.[78] Again, despite the appropriateness in a corporation law of dissolution provisions, that is probably not the place for a directive to the courts to dissolve a corporation "that has created a monopoly or unreasonably restrained competition in trade."[79] On the other hand, there are many sensitive areas in corporation law to which thought might be given for legislative attention, even though the final decision might well be to let those areas be hammered out by the common law through judicial decisions. Here are some of those sensitive spots.

1. *The corporate "entity"—its observance and disregard*—One has merely to look at the stream of cases in the courts to recognize that courts and lawyers are constantly facing the problem whether the separate entity of a corporation should be strictly observed or in some degree or other disregarded. The problem is particularly acute when, as so often happens, for one reason or another, what might broadly be viewed as a single enterprise is compartmentalized into a complex pattern of subsidiary and affiliated corporations. The problem becomes even more difficult when the subsidiaries and affiliates are not wholly owned within the system. In addition, there is always a strong temptation to push a good thing like limited liability too far, so as to create virtually creditor-proof corporations, a problem sometimes categorized under the label "inadequately capitalized corporation"—not to be confused with the laudable motive of doing business on a shoestring so as to make one's capital go as far as possible.

Often the two phenomena, multi-incorporation and inadequate capital, go together. Witness the deplorable picture presented by the New York City taxicab concerns, some of which seem to have a "separate" corporation for each cab or for each two or three. What should a corporation statute do about this? No one, I venture, would have the hardihood to attempt to prepare a statutory statement for the law of corporate entity which, like a real "code" of foreign make, would purport to cover the field and give the answers to all possible future situations. It is an impossible task, more Herculean than even the bold New York legislative attempt to "cover" the law of pre-emptive rights. Shall a corporation act, then, be silent, as is the Business Corporation Law and as are corporation laws generally? Might not a statute at least "flag" the problem for lawyers and judges by a brief sentence somewhere, either in the section touching on corporate existence or in the section touching on shareholders' liability, that corporate existence does not per se in a proper case prevent disregard of the corporate entity? Perhaps even an oblique reference to inadequate capital or to business-enterprise entity or to unreasonably compartmentalized enterprises might not be out of place.

78. See, for instance, Tex. Bus. Corp. Act, art. 2.01 (B) (Vernon's) forbidding corporations to be formed under that Act for combining certain businesses, such as cattle raising and meat packing, or oil producing and oil-pipe lining.

79. See Vt. Stat. Ann. tit. 11, § 551 (1958).

2. *Close corporation abuses*—High-handed maltreatment of minorities is to be found more frequently, I venture, in the close corporation than in publicly-held corporations. The close corporation is particularly susceptible to power plays by the controlling shareholders. The family owning 51 per cent of the stock of a booming close corporation can live in luxury while the family owning 49 per cent starves. Subtle and not so subtle squeeze plays can be engineered by the majority to force the minority out,[80] at a sacrifice price. True, foresighted arrangements can be made to minimize this danger,[81] but one wonders whether the legislature cannot help out a bit here in other directions (e.g., compulsory dividends) and not just leave each case to be decided on common-law principles as it arises. Of course, the new Business Corporation Law's Section 620 is most helpful in at least permitting charter-embodied contractual arrangements for protecting the minority shareholder in tenure, salary, dividend restrictions, compulsory dividend payments, *et al.*; and the new Law's recognition of high-quorum provisions, high-vote provisions, and dissolution-as-of-right provisions, already mentioned, are most valuable to foresighted prearrangers. Perhaps we should not worry too much about those not sufficiently foresighted, even if they were seduced into a state of security and confidence in the early honeymoon stage. Still, might not a minority shareholder be given by statute an absolute right to compel periodical distribution of a portion of the earnings?

3. *Unfair alteration of senior shares*—Since junior (common) shares usually have the preponderant control in election of directors and since it is accordingly easy for those in control to identify corporate welfare with the welfare of the common shares (or, to put it differently, to confuse the common good with the good of the common) senior shares are vulnerable to an attack on their priorities through a recapitalization plan submitted to shareholders' vote. The theoretical legal safeguard that requires a favorable class vote of the preferred before the plan can be adopted has proved in practice to be no barrier to plans unfair to the preferred, even aside from the case where adversely interested juniors own a majority of the preferred. In corporations with many shareholders, the proxy voting system permits those in control of the proxy machinery pretty much to direct the voting.[82] What can or should a

80. See O'Neal & Derwin, Expulsion or Oppression of Business Associates: "Squeeze-outs in Small Enterprises" (1961).

81. O'Neal, Arrangements Which Protect Minority Shareholders Against "Squeeze-outs," 43 Minn. L. Rev. 537 (1961); O'Neal & Derwin, supra note 80 at ch. VII, pp. 168-190.

82. Although the American proxy system helps the control group to direct the course of shareholder voting, management pretty well achieves the same end in foreign countries where the system of shareholder voting depends more on personal attendance and information imparted at the meetings. So, although the law on the books in certain foreign countries is that the shareholders are the ones, in assembly, to determine the amount of dividends and executive salaries, here is what actually happens, as observed from personal experience:

The shareholders' meeting is called for 10:00 A.M. and scheduled to last till noon. But even if not scheduled to adjourn at noon, adjournment at that hour is predestined

corporation act do to minimize the possibility of abuse? As I have suggested elsewhere,[83] there are a number of protective features that might be considered: require a judicial or administrative finding of fairness before changes in senior shares can become effective; permit shareholders to challenge a plan for lack of fairness; put the plan of alteration of shares into the regulated Blue Sky area by defining an invitation to vote on the plan to be a "sale" of a security; permit dividends on senior shares to be paid out of profits of current or recent periods regardless of surplus (subject to safeguards for creditors), and regardless of charter provisions, so as to remove one club (or is it a carrot?) whereby the preferred is induced to vote for a sacrificial plan; and shift the voting power to the preferred to elect either a majority or the highest possible minority of the board when arrearage on the preferred piles up to a certain point. There may be other possibilities.

The new Business Corporation Law, however, contains nothing along such lines, as is the case with the corporation statutes of most other states. The difficulty is that strong argument can be made against any proposable protection. Maybe the New York revisers are right in their apparent belief that there is more to be lost than gained by such experimental protective features; perhaps the requirement in the new Business Corporation Law of class voting (Section 804) and provisions for cash to dissenters (Sections 860(b)(6), 623) were deemed to achieve sufficient rough justice, even without a statutory effort to see that the "fair value" of the preferred shares must take strong account of the arrearage rights given up under a recapitalization plan.

4. *Prejudice to senior shares from dividends and repurchases*—Prejudice to senior shares can arise from dividends to junior shares and from repurchases of shares of junior classes in certain situations. The Business Corporation Law partially meets the problem by, in effect, defining "stated capital" to include the consideration received for no par preferred shares up to the liquidation priority and by forbidding dividends or share repurchases except from surplus, defined as net assets in excess of stated capital.[84] But if the preferred has

anyway because nothing short of a catastrophe can keep the citizens from the big event of the day, the mid-day meal—an event with only a slight edge over the daily event of second importance, the evening meal. Soon after the meeting opens, the secretary of the corporation reads, slowly, a long, long report to shareholders, a report which each shareholder had already picked up at the door when he entered and with which he carefully follows the secretary's reading. The Report usually devotes much of its space at blasting the Government for not having done those things that it ought to have done to help the industry and for having done the things that it ought not to have done which, in turn, have thrown impossible obstacles in the company's road to success. This takes till about 11:30 A.M. Following that, a few questions planted in the audience give the officers of the company the occasion to do some easy fielding of infield grounders and even to come to bat and hit a few pitches over the fence. By that time the crowd is beginning to stir and move towards the door, becoming anxious to get to the crowded public transport ahead of the others. As the exit movement approaches the hubbub stage, motions are made by the right people at the right time for the dividends and executive salaries to be paid, which motions are carried viva voce, and that's that.

83. Latty, Exploration of Legislative Remedy for Prejudicial Changes in Senior Shares, 19 U. Chi. Rev. 759 (1952).

84. N.Y. Bus. Corp. Law §§ 506(b); 510(a), 513(a).

par value, that still leaves the possibility of dividends to, or repurchase of, "under-water" common when there is technically a "surplus" even though the corporate assets are below the liquidation priority of the preferred. (There is also, of course, the possibility of manufacturing a surplus by a reduction of "stated capital" voted by the shareholders, coupled with a reduction of the liquidation priorities of the senior shares; but here, too, there would be the safeguard of class voting and cash to dissenters.) Furthermore, even the existence of a surplus does not mean that seniors have nothing to complain about when junior shares are being repurchased. If, for instance, at the time there are substantial unpaid accrued dividends on the senior shares, one might urge that the corporation should be paying off those accruals if it has cash to spare instead of buying junior shares, with possible exceptions for special cases of repurchases comparable to those rare repurchases permissible even out of capital under Section 513(b) of the Law. But (except for creditor solvency) the only restriction in the Business Corporation Law is the above-mentioned surplus requirement. Moreover, repurchase of even preferred shares can be prejudicial to that class if it is part of a plan to drive down the price by passing dividends, letting unpaid accrued dividends pile up, and then buying up the shares cheap. Nothing in the Business Corporation Law attempts to meet this problem; one possibility might be to forbid purchase of shares with substantial dividend accruals except through redemption, unless the market is apprised of the proposed purchases.

5. *Favoritism through repurchase of shares*—The reverse of the pre-emptive-right coin would seem to be the opportunity for all holders of shares of a class to get equal treatment on the corporation's repurchase of shares of that class, although this brings up many of the difficulties associated with strict adherence to pre-emptive rights. With some exceptions, perhaps repurchases should be permitted only pro-rata or in the open market, unless the rest of the holders of that class of shares approve the purchase by at least a majority of those voting. Whether the possible abuses in this area are of sufficient importance to justify legislative attention is debatable, especially since the common law of "fiduciary" duties is not entirely toothless. At any rate, the Business Corporation Law does not concern itself with the problem.

6. *Noncumulative preferred; shares at sufferance*—Like the laws of most states, the Business Corporation Law gives virtually complete freedom in the writing of the charter provisions that set forth the characteristics of the corporation's authorized shares. On the whole, this is good. But there is one situation that might give us pause: the creation of noncumulative preferred shares. The basic idea behind the noncumulative feature is sound enough: if the corporation is not operating at a profit and accordingly does not pay full dividends to the preferred, no "accruals" ("arrearages") mount up to the preferred's credit. The preferred just shares in the corporate misfortunes of the moment and does not by those misfortunes begin to eat up the common's "equity." To

that extent, noncumulative preferred serves a business need. The abuse arises when the directors, who typically owe their election to the common shares, pass up dividends on the noncumulative preferred even when, in addition to any surplus required by law for dividends, there are current and recent earnings. If "noncumulative" means "gone and gone for good," with no credit piling up in favor of the preferred just as in no-earnings periods, this preferred stock becomes a strange kind of property indeed. It is a business co-ownership that participates in the profits of the venture to the extent that the directors so decide—when, as, and if. If any public official had such power over a citizen's property, we would be justly worried.

Rough as is the unrestricted noncumulative feature, one could put up with it if it served a business need. It does not. One statutory measure to meet the situation might be to compel the granting of a dividend credit on even noncumulative preferred, to the extent that earnings and dividend sources permit, just as if the preferred were cumulative. True, that would present some difficult problems, including measurement of earnings, accounting, and recording. Presumably, the Business Corporation Law's silence reflects the view that either the problem is not too serious or that it is too difficult to work out a legislative solution.

7. *Self-dealing*: *some specific patterns*—Even though there is ample justification for the repudiation by the Business Corporation Law of any final vestiges of the old New York doctrine rendering void or voidable any transaction approved by adversely interested directors, the fact remains that it is a severe strain upon human nature to be allowed to be judge of one's own case. Particularly to be distrusted, some would say, is one's own estimate of the worth of his obviously unique and superior services. I venture that few individuals, much less entire broad categories like, say, truck drivers or college presidents, could safely be left to decide their own wages or salaries. Yet in corporate enterprise, one frequently encountered pattern of self-dealing is the fixing by directors of their salaries and fringe benefits as executives, both in close corporations where the few shareowners are the management, and in many widely held corporations. Perhaps little more can be done legislatively than to state that the deal can be upset unless "fair and reansonable," as says Business Corporation Law, Section 713(a)(3). Yet it is not uncommon in various areas of law where a "fairness" requirement is imposed for tests or standards or earmarks of fairness to develop. With specific reference to self-determined compensation, might not a statute suggest that a standard of fairness is what such services would bring in arm's-length bargaining? But, of course, there are complications, such as upsetting the compensation years later.

8. *Same*: *stock options*—The very title of Dean Griswold's article in a fairly recent issue of the *Harvard Business Review*—"Are Stock Options Getting Out of Hand?"—indicates, I believe (a belief reinforced by casual talks with "outside" shareholders), that considerable misgivings exist about execu-

tives' stock options.[85] There is a feeling, perhaps shared mostly by non-executives and by no-option executives, that the device is being abused.[86] Aside from some very serious broad questions of fair-sharing of the tax burden, of hidden costs and optical illusions, of the reality of the incentive factor, of windfalls from general business booms, and others,[87] one wonders whether, again, the basic trouble here is self-dealing, in one degree or other, in many cases at least. Just as there is probably no such thing as "too high" a salary where a corporation goes outside after a top executive who drives a hard bargain, so too, there may be little cause for complaint where the outside executive demands a big stock option for coming in. But that is not the usual picture in stock-option grants. At least, it is quite possible that even the device of putting the actual awarding of the option in a committee of the board whose members are not personally sharing in the plan is not necessarily an assurance of complete objectivity and "arm's length." (It is, of course, better, or at least more subtle, than the old mutual back-scratching technique of the reciprocal sitting-out at meetings by interested board members.) There is a suspicion that the sharing insiders have too great a hand in shaping the stock-option plan or have such relations to the "outside experts" or "outside directors" as to make arm's-length evaluation difficult.[88]

Query what, if anything, can be done about it in a corporation statute. Perhaps periodical reapproval of stock-option plans might be required of shareholders, after submission to them of full information of benefits awarded and options exercised under options over a recent period of years. I suggest this without enthusiasm, having little faith in the vote of large masses of shareholders on submitted proposals, except in unusual circumstances. Perhaps a statute might well require periodic reports to shareholders on options or shares so that they can see who is getting what and for how much. The Business Corporation Law has not overlooked the problem; it does at least require shareholders' approval of "a plan" if stock options are to go to directors, officers, and employees,[89] but the plan needs no periodical reapproval.

9. *Same: indemnification of management*—Indemnification of directors and officers by a corporation when they have been put to expense on claims against them arising from their official activities, whether expense of successful defense, unsuccessful defense, settlement, of payment of judgments against

85. Griswold, Are Stock Options Getting out of Hand?, 38 Harv. Bus. Rev. 49 (1960). Cf. Henry Ford II, Stock Options Are in the Public Interest, 39 Harv. Bus. Rev. 45 (1961). Mr. Ford does, however, make the point that "if stock options amount only to unearned and quickly realized bonanzas" this is an abuse of stock options. Id. at p. 46.

86. Perhaps this is reflected in sporadic displays of judicial hostility. See, in one jurisdiction and within a brief space of time: Kerbs v. California Eastern Airways, Inc., 33 Del. Ch. 69, 90 A.2d 652 (Sup. Ct. 1952); Gottlieb v. Heyden Chemical Corp., 33 Del. Ch. 82, 90 A.2d 660 (Sup. Ct. 1952); but cf. Kaufman v. Shoenberg, 33 Del. Ch. 211, 91 A.2d 786 (Ch. 1952).

87. See Grisowld, supra note 85.

88. See letter quoted in Griswold, supra note 85 at 55.

89. N.Y. Bus. Corp. Law § 505(d).

them, can also be viewed as a problem in self-dealing. Typically the indemnification provisions are found in the certificate of incorporation or in the by-laws, and these in turn were set by the insiders; moreover, such indemnification clauses often expressly purport to make even decisions of adversely interested directors virtually final. Nevertheless, the corporation laws of most states permit management virtually to write its own ticket in this area.

New York's Business Corporation Law is one of the few enactments that keep indemnification of officers and directors within statutory restrictions.[90] The indemnification permitted by the statute is exclusive. When officers or directors are put to expense in a wholly successful defense (on the merits or otherwise), the corporation has a pretty free hand in indemnifying them.[91] In other situations, one permitted method of awarding indemnification is by a court. Other permitted methods are by disinterested directors upon a finding of absence of certain kinds of bad conduct or by vote of the shareholders; in either event, in specific cases, and not just by some general long-standing resolution. These features of the statutory scheme seem reasonable enough, subject to doubts that one may have about mandatory indemnification for expenses of successful defense *not* on the merits. More debatable is this permitted alternative: The board, although itself adversely interested, may indemnify a director or officer upon the opinion in writing of independent legal counsel that indemnification is proper in the circumstances on the ground that appropriate standards of conduct have been met by such director or officer.[92] (At this point I cannot refrain from observing that I know a distinguished lawyer of utmost integrity and highest character who is *always* and *honestly* of the opinion that his client is a fine, upstanding, solid citizen, free from blame, being unjustly attacked by one or more scalawags and who can always present a most convincing argument to that effect; in New York this gentleman would have a rewarding career under the new Business Corporation Law.) However, the Business Corporation Law creates additional safeguards by forbidding indemnification for a number of unreasonable items—*e.g.*, amounts paid in settling, unless with court approval.[93] Incidentally, the new Law distinguishes between a corporate (including derivative) suit and a third-party suit as to procedure for and permissible range of indemnification.[94] All in all, and despite the weak spots mentioned, here is a sensitive area that New York seems to have treated with some success in the new Law.

10. *Bargain-shares to insiders*—The weakness of human nature in the face of a temptation to get something for nothing, to get a free ride on someone else's contribution, and to pull strings that are at one's command to get a bargain at others' expense has long plagued corporation law, as shown in the legal lore

90. N.Y. Bus. Corp. Law § 721.
91. N.Y. Bus. Corp. Law § 724(a)
92. N.Y. Bus. Corp. Law § 724(b)(2).
93. N.Y. Bus. Corp. Law § 722(b)(1)(2).
94. N.Y. Bus. Corp. Law §§ 722, 723.

that centers around liability for promoters' "secret" profits and "watered" shares, including bonus and discount shares. To a great degree, the problem is again one of self-dealing and of fiduciary duties, with the spotlight on overvaluation of insiders' contributions and dilution of outside shareholders' interest. To a large degree, but not entirely, the vice is lack of full disclosure in the sale of securities, and perhaps for this reason, the inclination is to let statutes regulating the sale of securities to the public take care of the matter, particularly the Federal Securities Act of 1933 supplemented by state Blue Sky laws of various degrees of effective content and effective administration. Still, many cases of promoters' profits are not within either federal law or effective state Blue Sky legislation; even more so is that the case with watered stock. Accordingly, one may raise the question whether a corportion act itself might not lay down some principles of liability for recipients of watered shares, promotional shares, and insiders' bargain shares. The least this might do would be to dispel some of the questionable common-law doctrines and distinctions, such as distinctions between par and no par shares in relation to liability on shares, donation-back techniques to evade liability through the disguise of financing by treasury shares, *et al.* The attempt has hardly ever been made. It is not surprising that the Business Corporation Law seems to leave the matter alone, trusting to the common law, federal regulation of sale of securities, and the Martin Act.[95]

11. *Shareholder suit abuses*—One sensitive topic treated in the new Act, as in prior New York legislation, and perhaps of greater sensitivity in New York than elsewhere because of the financial prominence of New York City, is the shareholder strike-suiter. The New York solution for deterring shareholders' suits might not be the best solution elsewhere, but New York has by now presumably had enough experience to warrant continuation in the Business Corporation Law of the scheme that permits the corporation in a derivative action to require the plaintiff to post a bond as security for the litigation expenses of the corporation and of persons entitled to indemnification from the corporation,[96] and the requirement aimed at preventing later purchase of shares on which to base complaints for earlier grievances.[97] One new wrinkle may further discourage all but the hardiest derivative-suiters: The corporation may *advance* to the defendant officers and directors their expenses of defense, subject to ultimate accounting.[98] Maybe the moral here is that when the ill gets too great, one resorts to very strong medicine for the antidote.

12. *Evasion of local protective corporation law features through pseudo-foreign corporation*—A great barrier to the inclusion of strong protective features in any state corporation law long has been the utter futility of such features in face of the ease of evasion by simply incorporating in a state free

95. N.Y. Gen. Bus. Law, art. 23-A, §§ 352-359-h.
96. N.Y. Bus. Corp. Law § 627.
97. N.Y. Bus. Corp. Law § 626(b).
98. N.Y. Bus. Corp. Law § 726(a).

from controls and then bringing the resulting "foreign" corporation into the state to do business as a foreign corporation that is regulated, particularly in its internal affairs, by the law of the state of incorporation. The first attempt to thwart this evasion was in the new North Carolina Business Corporation Act as embodied in the bill which presented the proposed new Act to the legislature.[99] In that bill, many specific provisions of the new domestic corporation law were to be made specifically applicable to pseudo-foreign corporations, as defined, including: invalidation of indemnification provisions for directors and officers; directors' liability for forbidden dividends, share repurchases, and loans; jurisdiction over nonresident directors; fiduciary duties of insiders; compulsory dividends; shareholders' liability for illegal dividends and watered stock, subordination of insiders' claims requirements relating to fundamental changes in outstanding shares; *et al.*[100] There were even provisions aimed to thwart evasions by forming a foreign parent corporation to own the local corporation.[101] The attempt was abortive, the failure being to a great extent due to the unfortunate label "pseudo-foreign corporation." That phrase sounded too much like a dirty name, enough to arouse resentment, which, once aroused, could not be calmed by a belated semantic change.

The New York revisers were fully aware of the North Carolina attempt. In the text of the law as originally enacted, the revisers showed greater semantic skill when they invented a more euphonious term, "domiciled foreign corporation," defined as one in which either two thirds of all shares are owned by residents of New York or two thirds of the *voting* shares are so owned, or at least two thirds of its business income is allocable to New York for franchise tax purposes under the tax law.[102] However, only a mild application of New York's Business Corporation Law was made to such foreign corporations, chiefly directors' liability for dividends, share repurchases and redemptions unlawful by New York law and managerial accountability for misconduct.[103] However, by the March 8, 1962, amendment to the Business Corporation Law this concept and definition of "domiciled foreign corporation" was abandoned,[104] *in name* at least, in favor of a scheme that operates as follows: (1) all foreign corporations doing business in New York and their directors and officers are expressly subject to specified sections of the Business Corporation Law (many relating, one might say, to "internal affairs") just as if the corporations were New York corporations;[105] (2) however, foreign corporations and their directors

99. N.C. Session 1955, S.B. No. 49.
100. N.C. Sess. Laws 1955, ch. 55, § 134.
101. N.C. Sess. Laws 1955, ch. 55, §§ 135, 136.
102. N.Y. Bus. Corp. Law § 1317 (as originally enacted and before the March 1962 amendments).
103. N.Y. Bus. Corp. Law § 1318 (as originally enacted and before the March 1962 amendments).
104. Amendatory Bill, Assembly Int. 4918, Pr. 5212 (Feb. 20, 1962), Senate Int. 3774, Pr. 4287 (March 8, 1962).
105. N.Y. Bus. Corp. Law §§ 1317, 1318, 1319 (as changed by the March 1962 amendments).

and officers are exempted from the application of designated provisions of the Business Corporation Law that would otherwise be applicable if the foreign corporations' shares are listed on a national securities exchange or if less than one half of their business income for certain preceding fiscal periods was allocable to New York under the tax law.[106] Apparently the idea is that if the shares of a foreign corporation are listed on a national stock exchange, the corporation is a cosmopolite and not a New Yorker, however otherwise indigenous it may be to the Empire State. (Perhaps also there may be some force in an argument that a person who is contemplating buying shares listed on an exchange and who is concerned as to what state's law will effect him and the "internal affairs" of the corporation should find an easy answer by simply ascertaining the state of incorporation.) Likewise, the statutory idea seems to be that when most of a foreign corporation's income comes from outside and not from New York, then it might just as well be viewed as a really foreign corporation for determination of applicable "internal affairs" law and not as a New Yorker. But there will still remain some close foreign corporations that are so New Yorkish in tinge that local New York corporation law will apply even to some of their "internal affairs." So, the earlier New York statutory concept of "domiciled foreign corporations," though abandoned in name, persists in effect, but with a much-altered content.

The interplay of the new pattern of application and exclusion of the Business Corporation Law to foreign corporations is very technical and detailed,[107] but perhaps a rough summarization might be this: even non-New-Yorkish foreign corporations (and their directors and officers) and subject to certain provisions of the local corporation law; while New-Yorkish foreign corporations, in addition, are as subject as are domestic corporations to the Business Corporation Law's provisions relating to: voting trust records; the liability of directors for dividends, distributions, share repurchases and redemptions and loans, if unlawful for domestic corporations; failure to disclose to shareholders the affect on the capital and surplus accounts of dividends and distributions from sources other than earned surplus and of certain capital-structure changes (share dividends, reclassification of shares, canceled treasury shares, capital reductions by directors, "accounting reorganizations," conversion of securities into other securities) and the rather *sui generis* New York scheme for indemnification of directors and officers. However, except for the latter (indemnification) one may entertain doubts as to whether the Business Corporation Law is in any event significantly regulatory or protective in comparison with the law of other states. Anyhow, all these provisions probably can be avoided, if it is worth the bother, by forming, say a Delaware holding com-

106. N.Y. Bus. Corp. Law § 1320 (as changed by the March 1962 amendments).

107. N.Y. Bus. Corp. Law §§ 1317, 1318, 1319, 1320—all relating to foreign corporations—may involve application of the Law's domestic provisions set forth in many sections, viz., §§ 510, 511, 515, 516, 519, 520, 623, 626, 627, 719, 720, 721, 722, 723, 724, 725, 726, 808, 907, as well as the sections in articles 1 and 3.

pany for a New York subsidiary (the operating company) under a carefully planned setup whereby the parent would not be "doing business" in New York. This little detail shows one difficulty with "protective" features: To close loopholes you have to resort to complicated provisions, with the possibility that the greater the complication, the more numerous the loopholes.

Concluding Observations

Using the abused word "liberal" in a Delaware corporation law sense, one may say that New York's new Business Corporation Law is a conservatively liberal act. It contains no revolutionary novelty or startling boldness—nothing like, say, doing away with par value, a concept which is useless, confusing and outmoded. (This is particularly true since the advent of "low-par" shares, which better merit the label "fictitious par value" rather than the frequent "nominal par value.") The new Law's nearest approach to significant new invention is its application of selected features of New York corporation law to foreign corporations authorized to do business in New York, but the effort is not a very strong one and the trail had already been blazed elsewhere. As a landmark in American corporation law, this Act is nowhere near as significant as the New Jersey corporation law of 1896.

If the Business Corporation Law is, first of all, an "enabling" act that furnishes the motive power (with power steering) and leaves it to the courts to put on the brakes at the instance of the vigilant, that reflects the complacent spirit of the time in corporation law. If the Law shows only very mild reformist concern with preventing, curing, or mitigating abuses, that is also understandable. Any novel protective feature is highly controversial, with the risk of creating more difficulties than it solves,[108] and runs into endless ramifications and "overdrafting." Moreover, it could plausibly be urged that general principles of common law and equity jurisprudence may well be adequate, in general, to take care of many of the "abuse" situations. On the other hand, the Business Corporation Law does not completely reflect the spirit of complacency to the extent of exhibiting an attitude that management can or will do no wrong, which is one source of complacency in corporation law. Witness the Business Cor-

108. I am reminded of a bit of history on one textile corporation related to me by a lawyer friend. Many years ago the corporation brought in an ambitious dynamic young man as chief executive. His influence got to dominate the Board. The shares were not listed and the holders were scattered and passive. Over the years, what with charter amendments creating new classes of shares, cash bonuses and options to buy shares at bargain prices with the bonus cash, reclassification of outstanding shares, creation of new redeemable shares and offers of exchange of new shares for old, redemption of shares outstanding through such exchanges, and some actual share purchases from shareholders offering to sell cheap, this executive ended up virtually owning the company, aided by high salaries to him approved over the years by a controlled Board. I don't know how you can frame a corporation law to legislate against that sort of thing. The trouble is not so much inadequacy of the law, common or statutory, as failure of the aggrieved parties to be alert and informed and take timely steps to frustrate the unlawful grabs. Perhaps of all laws, the corporation laws are the ones which best point up the reminder: *vigilantibus non dormientibus leges subvenient.*

poration Law's restrictions on insiders' indemnification as compared with most of the recent corporation law revisions in other states.

We said, near the beginning of this paper, that an examination of the new New York Business Corporation Law might allay misgivings about teams and committees. Even so, when one reflects on the hundreds of thousands of dollars and scores of thousands (at a guess) of man-hours that went into this venture, one wonders.